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INTERNAL REVENUE SERVICE

E/GE TECHNICAL ADVICE MEMORANDUM

Area Manager:

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Years Involved:

Conference Held:

LEGEND:

A =
B =
C =
D =
E =
F =
G =
H =
I =
J =
K =
L =
M =
O =
P =
Q =
R =
T =
U =
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W =
X =
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Date 1 =
Date 2 =
Date 3 =
Date 4 =

Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
Date 10	=
Date 11	=
Date 12	=
Date 13	=
Date 14	=
Date 15	=
Date 16	=
Date 17	=
Year 1	=
Year 2	=
Year 3	=
b	=
c	=
d	=
e	=
f	=
g	=
h	=
i	=
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u	=
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w	=
x	=
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z	=
aa	=
bb	=
cc	=
dd	=
ee	=
ff	=
gg	=
hh	=
ii	=
jj	=

kk =

ISSUES:

1. Whether W qualified as an insurance company under section 501(c)(15) of the Internal Revenue Code for tax years ending December 31 of Year 1 and Year 2.

2. Whether W was a member of a controlled group as defined in section 1563 of the Code (as modified by section 831(b)(2)(B)(ii)) as of December 31 of Year 1.

3. If W was a member of a controlled group as of December 31 of Year 1, has W exceeded the premium limitation of $350,000 set forth in section 501(c)(15) of the Code for tax year ending December 31 of Year 2?

4. Whether W, a foreign company that made an election under section 953(d) of the Code continues to qualify for the election if it is not an insurance company.

5. Whether W can rely on the determination letter granted by the Service allowing it to claim tax exempt status under section 501(c)(15) of the Code.

6. If W cannot rely on its determination letter, what is the effective date of revocation?

7. Whether W is entitled to relief pursuant to section 7805(b) of the Code.

FACTS:

W was incorporated in R on Date 1. Effective Date 2, W assumed the assets, liabilities and insurance business of P, a former member of the C.

Since its inception, W has been owned by V, a domestic partnership. During Year 1, V had several ownership changes. As of January 1 of Year 1, z% of the profits, loss, and capital interest were held by A and cc other individuals. Q, the Managing Partner of V since Date 14, acquired a capital interest during the first aa months of Year 1. Upon the sale of Q to O in Date 7, Q's interest in V was sold to X, an entity exempt under section 501(c)(15) of the Code located in R. X owned an bb% capital interest only in V (and thus W) as of Date 8. During December of Year 1, X acquired the profits and loss interests and the balance of the capital interests of the remaining individual partners but for A and B, such that V (and thus W) was owned dd% by X, ee% by A, and ff% by B. By December 31 of Year 3, V was owned z% by A and X.

W's predecessor, P, previously filed a Form 1024 Application for Recognition of Exemption under Section 501(c)(15) of the Code on Date 3. In its application, W described its activities as follows:

> P commenced writing business as a member of the C in Date 10 and continues to write business through the C until it ceased accepting business in Date 11. At that time U executed an E Agreement with the C and has been running off its business since that time through T.

During the time U was writing business, they wrote both property and casualty business on a direct/facultative and treaty reinsurance basis.

* * *

U is committed to remaining as an active writer of insurance business. U is currently reviewing proposals that will facilitate its withdrawal from the C via an F Agreement which will allow it to move its operations to a new jurisdiction where it cannot only run off its C business, but can accept new business for its own account. U has explored the possibility of joining the G and is negotiating with the H about redomesticating its Charter to that state to enable it to begin writing insurance premiums in the State of I. Action on these proposals is expected before mid-year Date 13.

P described its present and future sources of financial support as follows:

> As an insurance company in run-off the primary source of income is from invested assets. The company is also recovering losses under a catastrophe reinsurance contract and currently expects to recover approximately $gg over the next year. The endeavors cited ... above will generate income from new business written in the new jurisdiction.

The Service granted P tax exempt status under section 501(c)(15) of the Code on Date 4.

W filed a Form 1024 on Date 5, seeking tax exempt status under section 501(c)(15) of the Code. W described its activities on Form 1024 as follows:

> W is the successor of P which was an underwriting member of the C. W commenced writing business as a member of the C in Date 12 and continued to write business until Date 15 of that year when C ceased to accept business. At that time U executed an E Agreement with the C.
>
> Through a transfer of assets and liabilities on Date 2, W will continue the insurance business of P from its domicile in R. In the future the company will continue to insure business at a level which will qualify for the tax exemption.
>
> W was formed specifically to continue the operation of P due to valid business reasons necessitated by the D. Shareholders of W are the same as P.

W further explained,

> In Date 11, P executed an E Agreement with the C and has been running off its business since that time through its J Company.
>
> In order for the C to cease operations, P was forced to withdraw from the C and find a new jurisdiction where it could continue the run-off of the C business. Through a transfer of K ... P withdrew from the C and transferred its operation to W as of Date 2.

W represented that its present and future sources of financial support would be "derived from premium income and investment income."

The Service granted W's request for tax exempt status on Date 6. W has made the election under section 953(d) to be treated as a domestic corporation for United States income tax purposes.

During Year 1 or Year 2 W had in-force coverage originating through the C which it assumed in the Date 13 reorganization with P.

W has been in run-off of the coverage originating from the C. This run-off began in Date 17 under P and after the Date 13 reorganization continued under W through Year 1 and Year 2. From its inception through Year 2, W's assets and surplus grew. As part of its Date 13 Form 1024, W reported Date 13 surplus of $b on assets of $c and loss reserves of $d. An equity contribution of $e was made to W in Date 14, bringing its contributed surplus to $f, on assets of $g. The Year 1 financial statement for W indicates that it had surplus of $h on assets of $i with loss and loss expense provisions of $j. The Year 2 statement indicates W had surplus of $k on assets of $l with loss and loss expense provisions of $m. The notes to the Year 2 statutory return filed with the Insurance Division of the R's L indicate that in Year 1 W "advanced $n" to X by a note that "is non-interest bearing and has no fixed terms of repayment." By the end of Year 2, surplus was $o on assets of $p. While assets and surplus were increasing, losses appear to have been declining. Loss and Loss Expense was reported as $q and $r for Year 1 and Year 2, respectively.

On its Forms 990, W reported "program service revenue" (i.e., insurance premiums) attributable to its run-off of P's previous insurance business totaling $s and $t for the tax years ending December 31 of Year 1, and December 31 of Year 2, respectively. W also reported reinsurance income of $u and $hh for the tax years ending December 31 of Year 1 and December 31 of Year 2, respectively, attributed to the reduction of loss & loss expense provision.

W represents that while in prior and subsequent years its insurance activities were superficially more extensive because of market conditions, the apparent dearth of activity during the years involved does not reflect the true nature and extent of its insurance activities during the years involved.

LAW AND ANALYSIS:

Issue One: Whether W qualified as an insurance company under section 501(c)(15) of the Code for years ending December 31 of Year 1 and December 31 of Year 2.

An insurance company other than life is exempt pursuant to section 501(c)(15)(A) of the Code if the written premiums for the taxable year do not exceed $350,000. If an entity is a part of a consolidated group, section 501(c)(15)(B) provides that all net written premiums (or direct written premiums) of the members of the group are aggregated to determine whether the insurance company meets the requirements of section 501(c)(15)(A).

For taxable years beginning after December 31, 2003, I.R.C. § 501(c)(15) grants tax exempt status to insurance companies "other than life ... if (i) the gross receipts for the taxable year do not exceed $600,000, and (ii) more than 50 percent of such gross receipts consist of premiums." See Pension Funding Equity Act of 2004, Pub. L. 108-218, Title II, § 206(a), (b), 118 Stat. 610, 611 (April 10, 2004). This change in the law does not affect W, however, because the taxable years at issue in W are Year 1 and Year 2.

Neither the Code nor the regulations define the terms insurance or insurance contract. The United States Supreme Court, however, has explained that for an arrangement to constitute insurance for Federal income tax purposes, both risk shifting and risk distribution must be present. Helvering v. LeGierse, 312 U.S. 531 (1941). The risk shifted and distributed must be an insurance risk. See, e.g., Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190 (7th Cir. 1978), cert. denied, 439 U.S. 835 (1978); Rev. Rul. 89-96, 1989-2 C.B. 114.

No single factor determines whether a company's primary and predominant business activity for a taxable year was the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. Thus, in some cases, a start-up company (or a company winding down operations) may qualify as an insurance company even if premiums represent less than half the receipts of the company provided the company's capital and efforts is devoted primarily to its insurance business.

For the years involved, an insurance company for federal income tax purposes is a company whose primary and predominant business activity during the year was the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. Section 1.801-3(a) of the Income Tax Regulations. W argues that its "activities in prior and subsequent years are relevant to evaluate its activities in the years in question." W represents that while in prior and subsequent years its insurance activities were superficially more extensive because of market conditions, the apparent dearth of activity during the years involved does not reflect the true nature and extent of their insurance activities during the years involved.

W cites no authority in support of their argument; this argument is contrary to the regulations and caselaw. The regulation clearly requires ascertaining the activity done "during the tax year". Section 1.801-3(a)(1) of the regulations. In Indus. Life Ins. Co. v. United States, 344 F.Supp. 870, 875 (D.S.C. 1972), aff'd per curiam 481 F.2d 609 (4th Cir. 1973), the court described this standard:

> [i]t is apparent that the nature and character of the business actually done in a particular tax year is controlling on whether a company is to be treated as an insurance company under the law. The test is applied on a year to year basis, so it is possible for a company to qualify as a life insurance company in one year, but not in the preceding or succeeding years.

And in Cardinal Life Ins. Co. v. United States, 300 F. Supp. 387, 392 (N.D. Tex. 1969), rev'd on other grounds, 425 F.2d 1328 (5th Cir. 1970), the court noted that "[m]oreover, the test is to be applied to the taxpayer on a year by year basis."

As W notes, companies running off in force coverage can qualify as insurance companies. See, e.g., H.R. Conf. Rep. No. 457, 108th Cong., 2d Sess. 2004 at 565. ("It is not intended that a company whose sole activity is the run-off of risks under the company's insurance contracts be treated as other than an insurance company, even if the company has little or no premium income.")

W's financial condition is not consistent with that of an insurance company that truly is in run-off. M's R Insurance Practice issued a Date 16 newsletter, Insurance Issues, in which the lead article was "Exit Strategies for Insurance Companies", i.e., "[i]nsurance companies (captive or otherwise) which are in run-off (i.e., no longer writing new business)". The article identified as an implication of being in run-off that "it is likely that the costs of conducting the run-off will become increasingly disproportionate in comparison to the level of activity and size of outstanding liabilities. Accordingly, shareholders and directors will be concerned that: the capital tied up in the run-off entity is providing a poor return (if any);...." The article then describes various options designed to hasten the closure process. Similarly, in describing run-offs, Jacoby Thwaites writes in "Winds of Change", Run Off Business, Autumn, 2002, that "it's a very great mistake to look at run off insurance as if it were a live insurance company suffering a temporary embarrassment of underwriters." Moreover, "[t]here's a great deal of concern in the industry about capitalization – whether there is too much or too little, about the need to deploy capital much more efficiently – and shareholders are deeply concerned about why they have capital tied up in run off." Accordingly, "[i]t is in the interests of the new companies now entering [the run off] market, those that are buying up run off companies instead of acting as outsourcing or management companies, to be as efficient as possible." The industry was (in Year 3) moving towards a mechanism that "tackles the business of run off by means of a capital base that buys it and then closes it as efficiently as possible in the hope of making something on the deal." This contrasts with the current system in which run offs are typically operated by a management company on fee-based terms, creating an incentive for delay.

A.M. Best provides a well-known and commonly relied upon service rating the financial condition of insurance companies. Among the tests A.M. Best uses to test profitability is the "operating ratio", which measures overall pre-tax operational profitability, and therefore does not reflect operating expenses or capital gains. A.M. Best considers that "[t]he normal range for this test for all types of insurers is from 85 to 95. An Operating Ratio of more than 100 indicates a company is unable to generate profits from its underwriting and investment activities." See, *2004 Best's Insurance Reports – Property/Casualty at xv and cover iv.* W's five year operating ratio for was ii for Year 1 and jj for Year 2.

Based on the foregoing, W was not operated during Year 1 and Year 2 in a manner consistent with the goals of a run off business. W's assets and surplus increased without a corresponding increase in the proportion of its loss reserves, which if anything decreased. W's expenses increased from Year 1 to Year 2, but this is largely attributed to bad debt/reinsurance loss; management fees declined. W did not undertake any efforts to either expedite closing the run off business or to develop additional business.

Issue Two: Whether W was a member of a controlled group as defined in section 1563 of the Code (as modified by section 831(b)(2)(B)(ii)) as of December 31, Year 1.

Whether the corporation is a member of a controlled group is relevant to determining whether it qualifies under section 501(c)(15) of the Code as a tax exempt insurance company. In order to qualify, the company's net or direct written premiums for the tax year must not be more than $350,000. For purposes of determining whether the company has more than $350,000 of premiums, the company is treated as receiving the premiums received by all members of the controlled group. Section 501(c)(15) provides that "controlled group" has the meaning given such term by section 831(b)(2)(B)(ii). Under section 831(b)(2)(B)(ii), the term "controlled group" means any controlled group as defined in section 1563(a), with certain modifications.

Section 501(c)(15)(A) of the Code provides that insurance companies, other than life insurance companies, will be exempt from Federal income taxes if their net or direct written premiums do not exceed $350,000. In determining whether an insurance company meets the $350,000 premium limitation, section 501(c)(15)(B) provides that such company shall be treated as receiving amounts which are received by all other companies or associations which are members of the same "controlled group."

Section 501(c)(15)(C) refers us to the definition of a controlled group in section 831(b)(2)(B)(ii). Under section 831(b)(2)(B)(ii), the term "controlled group" means any controlled group of corporations as defined in section 1563(a), except that (I) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a); and (II) subsections (a)(4) and (b)(2)(D) of section 1563 shall not apply.

Section 1563(a) of the Code contains multiple definitions of a "controlled group of corporations." Section 1563(a) enumerates four types of controlled groups. During the years at issue, these groups were defined as follows: (1) Parent-subsidiary controlled group--one or more corporations connected with a common parent through stock ownership of 80 percent or more by voting power or value; (2) Brother-sister controlled group--two or more corporations if five or fewer persons who are individuals, estates, or trusts, own (within the meaning of subsection (d)(2)) stock possessing 80 percent or more by voting power or value of each corporation and more than 50 percent by voting power or value of each corporation taking into account only identical stock ownership of each person; (3) Combined group--three or more corporations each of which is a member of a group of corporations described by paragraph (1) or (2), and one of which is a common parent corporation in a group described in paragraph (1), and is included in a group of corporations described in paragraph (2); and (4) Certain insurance companies--two or more insurance companies subject to taxation under § 801 which are members of a controlled group described in paragraph (1), (2) or (3) shall be treated as a controlled group of corporations separate from any other corporations that are members of the controlled group of corporations described in paragraph (1), (2) or (3).

During the years at issue, W was part of X's parent-subsidiary controlled group. A parent-subsidiary controlled group, under section 1563(a)(1), consists of one or more chains of corporations connected through stock ownership with a common parent corporation if--

> (A) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (within the meaning of subsection (d)(1)) by one or more of the other corporations; and

(B) the common parent corporation owns (within the meaning of subsection (d)(1)) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

Again, under section 831(b)(2)(B)(ii) of the Code, "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a) and subsections (a)(4) and (b)(2)(D) of section 1563 shall not apply. As of Date 8, X owned an bb% capital interest only in V, a partnership, which wholly owned W. By December 31 of Year 1, X had acquired dd% of the interests in V. For the purpose of determining whether a corporation is a member of a parent-subsidiary controlled group, the partnership attribution rules of section 1563(e)(2) apply. Under section 1563(e)(2), "[s]tock owned, directly or indirectly, by or for a partnership shall be considered as owned by any partner having an interest of 5 percent or more in either the capital or profits of the partnership in proportion to his interest in capital or profits, whichever such proportion is the greater." Therefore, X is attributed ownership of W. On these facts, W was a member of X's parent-subsidiary controlled group as of Date 8, because X had acquired bb% of the capital interest in W. Additionally, W was a member of the X controlled group as of December 31 of Year 1 because X owned dd% of the interests in W. Y is likewise a member of X's controlled group because it is wholly owned by X.

The fact that section 1563(a)(4) of the Code does not apply under section 831(b)(2)(B)(ii) does not affect the analysis in this situation, since X's ownership of the interests in V qualifies W as part of X's parent-subsidiary control group. The fact that subsection (b)(2)(D) does not apply, likewise, does not affect the analysis because, as will be discussed further below, the provisions of subsection (b) are applied to determine which members of a controlled group are also "component members." According to the legislative history of section 1563 and the way that section 1563 has historically been applied, whether a corporation is a "component member" is irrelevant to the determination of whether it is a member of the controlled group.

W argues that, during the tax years at issue, neither W nor X was part of a controlled group. This argument is based on a misinterpretation of the statute, and a belief that an "excluded" corporation, defined by section 1563(b)(2) of the Code, is not part of a controlled group. The taxpayer argues that W is an excluded corporation, and not a member of a controlled group, for the taxable year ended December 31 of Year 1 under section 1563(b)(2) because it was only constructively owned, for section 1563(a) purposes, by X for approximately kk days in the year. Likewise, the taxpayer argues that X was not a member of the controlled group because it was a tax-exempt corporation under section 501(a).

Section 1563(b) of the Code defines "component members of controlled group of corporations" as all the members of a controlled group of corporations, except "excluded members." Excluded members are certain special status corporations. Section 1563(b)(2) lists each of the following corporations as an "excluded member of a controlled group of corporations:" (1) a corporation that is a member for less than one-half the number of days in the taxable year preceding December 31, (2) a corporation exempt from taxation under section 501(a) (except a corporation subject to tax on its unrelated business taxable income under section 511), (3) a foreign corporation subject to tax under section 881, (4) an insurance company subject to taxation under section 801, and (5) a franchised corporation.

W argues the term "excluded member of a controlled group of corporations" means that a corporation is excluded from membership in the controlled group. However, "excluded member" is a term of art referring only to certain corporations excluded from section 1563(b)(1) of the Code's definition of "component members," and does not affect a corporation's status as a member of the controlled group of corporations under section 1563(a).

The definitions in section 1563 of the Code are best understood by examining the way section 1563 operated in the context of section 1561, the provision for which section 1563 was originally written. At the time of the enactment of these sections, corporations were subject to a 30-percent normal tax on all income and a 22-percent surtax on income greater than $25,000. Because of this, large enterprises organized themselves into multiple corporations in order to reduce their tax rate (i.e. the enterprise enjoyed multiple surtax exemptions because each corporation claimed a surtax exemption). In response, Congress enacted sections 1561 and 1563 in order to limit the undue benefit large corporations were deriving from the creation of multiple corporate entities. Section 1561 allowed the controlled group a single surtax exemption, and that exemption was apportioned among component members of that controlled group. Section 1563(a) first identifies all the members of a single economic group by applying the controlled group definition to all related corporate entities, without regard to whether or not they are special status corporations. Then, section 1563(b) applies to determine which members of the controlled group (the component members) would apportion the surtax exemption. For purposes of this apportionment, the special status corporations were excluded.

In the context of section 1561 of the Code, it does not make sense to say that the controlled group does not include the special status corporations listed in section 1563(b)(2). For example, if these special status corporations were excluded from section 1563(a)'s definition of a controlled group, taxpayers would have still been able to simply circumvent section 1561 by inserting special status entities between other controlled group members to create multiple "controlled groups," each enjoying its own surtax exemption.

The legislative history of sections 1561 and 1563 of the Code states,

> [a]lthough the determination of the corporations included within a parent-subsidiary controlled group, or a brother-sister controlled group, is made without regard to the type of corporation involved, provision is made to limit the reduction in the surtax exemption (or payment of the additional tax) to those corporations, referred to in the bill as component members, whose income tax is determined in whole or in part by reference to the normal and surtax rates. Thus, exempt organizations which do not have unrelated business income, and foreign corporations which are subject to a flat tax rate on their income from sources within the United States, are not considered to be component members.

S. Rep. No. 88-830, at 152 (1964) (emphasis added).

Additionally, the legislative history of section 1563 of the Code illustrated, by several examples, that while tax-exempt corporations and corporations that were not members of a controlled group at least one-half the year were "excluded members," they were nevertheless included as members of a controlled group. H.R. Rep. 88-79, at A202-202 (1963). Example (3) states:

> Throughout calendar year 1964, corporation P owns all the stock of corporation F which, in turn, owns all the stock of corporations X and I. Corporation F is a foreign corporation subject to tax under section 881 of the code on its U.S. source income, corporation I is a life insurance company subject to tax under section 802 of the code, and corporations P and X are domestic corporations subject to tax under section 11 of the code. Each corporation files its returns on the basis of the calendar year. On December 31, 1964, corporations P, F, X and I are members of a parent-subsidiary controlled group of corporations as defined in section 1563(a)(1). However, corporations F and I are not component members of such group because they are excluded members within the meaning of section 1563(b)(2)(C) and (D). Thus, on December 31, 1964, the component members of the parent-subsidiary controlled group of which corporation P is the common parent are corporations P and X.

Similarly, longstanding regulations under section 1563 of the Code provide that members of a controlled group under section 1563(a), that are "excluded members" under section 1563(b)(2), nevertheless remain as members of the controlled group. For instance, Example (3) of section 1.1563-1(b)(4) of the regulations states:

> Throughout 1964, corporation M owns all the stock of corporation F which, in turn, owns all the stock of corporations L-1, L-2, X and Y. M is a domestic mutual insurance company subject to taxation under section 821, F is a foreign corporation not engaged in a trade or business within the United States, L-1 and L-2 are domestic life insurance companies subject to taxation under section 802, and X and Y are domestic corporations subject to tax under section 11 of the Code. Each corporation uses the calendar year as its taxable year. On December 31, 1964, M, F, L-1, L-2, X and Y are members of a parent-subsidiary controlled group of corporations. However, under subparagraph (2)(ii) of this paragraph, M, F, L-1 and L-2 are treated as excluded members of the group on December 31, 1964. Thus, on December 31, 1964, the component members of the parent-subsidiary controlled group of which M is the common parent include only X and Y. Furthermore, since subparagraph (2)(ii)(e) of this paragraph does not result in L-1 and L-2 being treated as excluded members of an insurance group, L-1 and L-2 are component members of an insurance group on December 31, 1964.

Reading section 1563 of the Code to provide that "excluded members" are not members of a controlled group is problematic, not only because it is inconsistent with the legislative history of section 1563 and the way in which section 1563 has been historically applied, but more importantly, because it could exclude controlled group members from the application of rules which were clearly intended to apply to such members. For example, section 267 defers a loss on the sale of property between two members of the same controlled group. Assume a wholly-owned U.S. subsidiary sells loss property to its foreign parent, subject to tax under section 881, realizing a loss. Generally, section 267 would require the loss be deferred. However, if "controlled group" is understood to exclude the types of corporations listed in section 1563(b)(2), then arguably section 267 would not apply to this transaction because the foreign parent would not be a member of the controlled group under section 1563(a) because the foreign parent would be an "excluded member" under section 1563(b)(2)(C). This reading of the definition of a controlled group would have an adverse effect on the administration of section 267 and contravenes the intent of section 267.

W points to an amendment to section 501(c)(15)(C) of the Code effective generally for years after 2003 providing that subsections (B) and (C) of section 1563(b)(2) shall be disregarded. W argues that, "[t]he legislative history of these amendments makes it clear that this was a change in the law and that prior to 2004 neither tax-exempt nor foreign corporations were included in a controlled group under section 501(c)(15)(B)." Therefore, the argument is that, in the tax years at issue here, tax-exempt and foreign corporations were excluded from the controlled group under section 501(c)(15)(B) and (C). For the years after 2003, the amendment would act to include these corporations in the controlled group. However, as already discussed above, a "controlled group" under section 1563(a) (and for the purpose of section 501(c)(15)(B) and (C)), is not limited to only the component members of the group. The clear intent of the amendment is that the income of all members of a controlled group be considered for the purpose of section 501(c)(15)(B) and (C). The legislative history of section 501(c) included no mention of the reason for the change in the statutory language in 2003. However, the amendment did not provide that tax-exempt and foreign corporations were excluded from the controlled group under section 1563(a) (and for the purpose of section 501(c)(15)(B) and (C)) either before or after the effective date of the amendment.

Because the X group obtained the requisite control during the tax year ending December 31 of Year 1, W became a member of that group during the tax year ended December 31 of Year 1.

Issue Three: If W was a member of a controlled group as of December 31 of Year 1, has W exceeded the premium limitation of $350,000 set forth in section 501(c)(15) of the Code for tax year ending December 31 of Year 2?

Because of the change in partnership structure (detailed above) during Year 1, W is considered a member of the controlled group beginning with the tax period ending December 31 of Year 1.

During the tax years ending December 31 of Year 1 and December 31 of Year 2, net written premiums (or if greater, direct written premiums) for the year are required to be aggregated with W. For the period ending December 31 of Year 1, neither Form 990 return reported written premiums, but rather premiums earned in the amount of $s for W and $v for X. Thus, for tax years ending Year 1, net written premiums did not exceed $350,000. For the period ending December 31 of Year 2, W again reported earned premiums of $w with no written premiums. However, for tax year ending Year 2, X filed Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return, showing net written premiums of $x, thereby exceeding the statutory limit of $350,000. When aggregated with X, the $350,000 limitation is exceeded for W.

Issue Four: Whether W, a foreign company that made an election under section 953(d) of the Code continues to qualify for the election if it is not an insurance company.

Section 953(d)(2)(B) of the Code reads as follows:

> (B) Termination. If a corporation which made an election under paragraph (1) for any taxable year fails to meet the requirements of subparagraphs (A), (B), and (C) of paragraph (1) for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.

In addition, Section 4.02 of Rev. Proc. 2003-47, 2003-2 C.B. 55, further clarifies the termination procedures applying to a section 953(d) election as follows:

> .02 Termination or Revocation of Section 953(d) Election
>
> (1) Once approved, the election generally remains effective for each subsequent taxable year in which the requirements of this revenue procedure and section 953(d) of the Code are satisfied unless revoked by the electing corporation with the consent of the Commissioner. However, if the electing corporation fails to timely file a return, pay the tax due as stated on the return, or comply with any other requirement for making the election contained in this revenue procedure and section 953(d), the Commissioner, in his discretion, may terminate the election as of the beginning of the taxable year after the taxable year with respect to which the failure occurs. If an election is terminated or revoked, the foreign corporation and its successors will be barred from making another election under section 953(d) without the consent of the Commissioner.

Section 953(d)(1) of the Code sets forth the requirements for a foreign corporation to elect to be treated as a domestic corporation. One requirement, contained in section 953(d)(1)(B), is that the electing corporation "would qualify under part I or II of subchapter L for the taxable year if it were a domestic corporation." Therefore, a corporation that failed to qualify as an insurance company under part I or II of subchapter L would fail the section 953(d) election requirement contained in section 953(d)(1)(B). In that case, the Commissioner may revoke the corporation's section 953(d) election in the year following the year that the corporation failed to qualify as an insurance company.

Thus, if it is determined that W failed to qualify as an insurance company during the Year 1 or Year 2 taxable years, the Commissioner may revoke the section 953(d) of the Code election in the year following the first year in which W failed to qualify as an insurance company. In addition, any revocation of W's section 953(d) election by the Commissioner would bar W from making another section 953(d) election without the consent of the Commissioner. In this respect, since W failed to qualify as an insurance company during Year 1 and subsequent years, W's section 953(d) election is revoked for all tax years after Year 1.

CONCLUSIONS:

1. W is not an insurance company exempt from tax pursuant to section 501(c)(15) of the Code as of December 31 of Year 1.

2. W is a member of a controlled group as defined in section 1563 of the Code as of December 31 of Year 1.

3. Since W is a member of a controlled group as of December 31 of Year 1, W has exceeded the premium limitation of $350,000 set forth in section 501(c)(15) of the Code for tax year ending December 31 of Year 2.

4. Since W failed to qualify as an insurance company during the Year 1 or Year 2 taxable years, the Commissioner revokes the section 953(d) election in the year following the first year in which W failed to qualify as an insurance company. In this case, revocation of the section 953(d) election is effective for tax year ending December 31 of Year 2.

5. W is not entitled to relief pursuant to section 7805(b) of the Code for tax years beginning January 1 of Year 1. Therefore, W cannot rely on its determination letter effective tax years beginning January 1 of Year 1. For tax years subsequent to Year 2, W filed Forms 1120-PC. This conclusion is responsive to your issues 5, 6 and 7.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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